

Estimating Farm Value

Badger Method

One of the simplest methods was developed in 1925 by Ralph Badger in his Valuation of Industrial Securities. The Badger method is a multiplier method which we will learn about in the next section. Badger set up a very simple system for identifying risk as denoted in Table 2.¹

Table 2: Badger Method for Assigning Risk

Classification	Percent	Translating Multiplier	Projected Value w/ Earnings of \$30,000
Class 1: Low Risk	12 to 14.99%	8.33 to 6.7	\$250,000 - \$200,133
Class 2: Medium Risk	15 to 19.99%	6.66 to 5.002	\$200,000 - \$150,075
Class 3: High Risk	20 to 24.99%	5.0 to 4.001	\$150,000 - \$120,048
Class 4: Very High Risk	25% and over	4 and lower	\$120,000 - less

The Badger method requires an appraiser to make a judgment call on how risky the business in front of them appears to be. There is not much guidance in determining the risk, but it is simple and provides a modest basis for judging risk. For instance, if the business is judged to fall into Class 3, a “High Risk”, it would result in a multiplier between 4 and 5. That multiplier is then applied to a projected cash flow to determine a value.

¹ Tuller, Lawrence W., The Small Business Valuation Book, Adams Media, 1994.

Schilt's Method

The Schilt's Risk Premium Table is another method of assigning risk to a small business opportunity. Developed in 1982 by James Schilt, this method, while similar to Badger in its simplicity, provides descriptions of the business type and risk premiums that are added to a risk-free measurements tied to the lowest risk government securities. Table # covers the

Schilt's Risk Premium for Discounting Projected Income Streams

In theory, the discount rate represents the sum of:

1. A "real" risk free return – 2%
2. An inflation premium – 5 – 6%
3. A risk premium associated with the particular investment volatility – 10%
4. An illiquidity premium – 10+%

Nos. 1 and 2 above can be represented by a long-term government instrument. Ex. 30 year US bond.

Nos. 3 and 4 is Schilt's "risk premium" value represented here

Category	Description	Risk Premium
1	Established businesses with a strong trade position, are well financed, have depth in management, whose past earnings have been stable and whose future is highly predictable.	6 – 10%
2	Established businesses in a more competitive industry that are well financed, have depth in management, have stable past earnings and whose future is fairly predictable.	11 – 15%
3	Businesses in a highly competitive industry that require little capital to enter, no management depth, element of risk is high, although past record may be good.	16 – 20%
4	Small businesses that depend upon the special skill of one or two people. Larger established businesses that are highly cyclical in nature. In both cases, future earnings may be expected to deviate widely from projections.	21 – 25%
5	Small "one man" business of a personal services nature where the transferability of the income stream is in question.	26 – 30%

Schilt's Risk Premium schedule.

The Schilt's method is commonly used when discounting cash flows which we will review in the next section.